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DEPARTMENT OF THE INTERIOR

Minerals Management Service

30 CFR Part 260

RIN 1010-AC14

Royalty Relief for New Leases in Deep Water

AGENCY: Minerals Management Service (MMS), Interior.

ACTION: Final rule.

SUMMARY: The Secretary of the Interior is authorized to offer Outer Continental Shelf (OCS) tracts in parts of the Gulf of Mexico for lease with suspension of royalties for a volume, value, or period of production. This applies to tracts in water depths of 200 meters or more. This final rule specifies the royalty-suspension terms for lease sales using this bidding system.

DATES: This final rule is effective [INSERT DATE 30 DAYS AFTER PUBLICATION].

FOR FURTHER INFORMATION CONTACT: Walter Cruickshank, Chief,
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SUPPLEMENTARY INFORMATION:

I. BACKGROUND

Legislative

On November 28, 1995, President Clinton signed Public Law 104-58, which included the Outer Continental Shelf Deep Water Royalty Relief Act ("Act"). The Act contains four major provisions concerning new and existing leases. New leases are tracts leased during a sale held after the Act's enactment on November 28, 1995. Existing leases are all other leases.

First, section 302 of the Act clarifies the Secretary's authority in 43 U.S.C. 1337(a)(3) to reduce royalty rates on existing leases to promote development, increase production, and encourage production of marginal resources on producing or non-producing leases. This provision applies only to leases in the Gulf of Mexico west of 87 degrees, 30 minutes West longitude.

Second, section 302 also provides that "new production" from existing leases in deep water (water at least 200 meters deep) qualifies for royalty suspensions if the Secretary determines that the new production would not be economic without royalty relief. The Act defines "new production" as production (1) from a lease from which no royalties are due on production, other than test production, before the date of the enactment of the Outer Continental Shelf Deep Water Royalty Relief Act; or (2) resulting from lease development activities under a Development Operations Coordination Document (DOCD), or supplement thereto that would expand production significantly beyond the level anticipated in the DOCD approved by the Secretary after the date of the Act. The

Secretary must determine the appropriate royalty-suspension volume on a case-by-case basis, subject to specified minimums for leases not in production before the date of enactment. This provision also applies only to leases in the Gulf of Mexico west of 87 degrees, 30 minutes West longitude.

Third, section 303 establishes a new bidding system that allows the Secretary to offer tracts with royalty suspensions for a period, volume, or value the Secretary determines.

Fourth, section 304 provides that all tracts offered within 5 years of the date of enactment in deep water (water at least 200 meters deep) in the Gulf of Mexico west of 87 degrees, 30 minutes West longitude, must be offered under the new bidding system. The following minimum volumes of production are not subject to a royalty obligation:

- 17.5 million barrels of oil equivalent (MMBOE) for leases in 200 to 400 meters of water;
- 52.5 MMBOE for leases in 400 to 800 meters of water; and
- 87.5 MMBOE for leases in more than 800 meters.

Regulatory

On February 2, 1996, we published a final rule modifying the regulations governing the bidding systems we use to offer OCS tracts for lease (61 FR 3800). New §260.110(a)(7) implements the new bidding system under section 303 of the Act.

We published an advance notice of proposed rulemaking (ANPR) in the Federal Register on February 23, 1996 (61 FR 6958), and informed the public of our intent to develop comprehensive regulations implementing the Act. The ANPR sought comments

and recommendations to assist us in that process. In addition, we conducted a public meeting in New Orleans on March 12-13, 1996, about the matters the ANPR addressed.

On March 25, 1996, we published an interim final rule in the Federal Register (61 FR 12022) specifying the royalty-suspension terms under which the Secretary would make tracts available under the bidding system requirements of sections 303 and 304 of the Act. We issued an interim final rule, in part, because we needed royalty relief rules in place before the lease sale held on April 24, 1996. However, in the interim final rule we asked for comments on any of the provisions and stated that we would consider those comments and issue a final rule. This final rule now modifies some of the provisions in the March 25, 1996, interim final rule.

On May 31, 1996, we published another interim final rule in the Federal Register (61 FR 27263) implementing section 302 of the Act. The interim final rule established the terms and conditions under which the Minerals Management Service (MMS) would suspend royalty payments on certain deep water leases issued as a result of a lease sale held before November 28, 1995. (The rule also contained provisions dealing with royalty relief on producing leases under the authority granted the Secretary by the OCS Lands Act.) We again asked for comments that we would consider before issuing a final rule.

Simultaneous with the publication of this rule, we are issuing another final rule (RIN 1010-AC13) to replace the interim final rule implementing section 302 of the Act. The final rule will revise 30 CFR 203 to establish conditions for suspension of royalty payments on certain deep water leases issued as a result of lease sales held before November 28, 1995.

II. Responses to Comments

One respondent--Exxon Exploration Company (Exxon)--submitted comments on the Interim Final Rule for Deep Water Royalty Relief for New Leases, issued March 25, 1996.

Exxon disagreed with our definition of the term "Field" (§260.102). Exxon said that our definition could be applied in such a way as to place unrelated and widely separated reservoirs within the same field. Exxon offered an alternative definition that it said provides for the creation of fields based on geology by allowing the inclusion of separate reservoirs in the same field when there is a meaningful geologic relationship between those reservoirs and avoids inclusion of reservoirs when such a relationship does not exist.

Exxon offered this alternative definition:

"Field means an area consisting of a single hydrocarbon reservoir or multiple hydrocarbon reservoirs all grouped on or related to same local geologic feature or stratigraphic trapping condition. There may be two or more reservoirs in a field that are separated vertically by intervening impervious strata. Separate reservoirs would be considered to constitute separate fields if significant lateral separation exists and/or they are controlled by separate trapping mechanisms. Reservoirs vertically separated by a significant interval of nonproductive strata may be considered as separate fields when their reservoir quality, fluid content, drive mechanisms, and trapping mechanisms are sufficiently different to support such a determination."

Except for a minor editorial change, we have decided to leave the definition of "Field" unchanged from the interim final rule for the following reasons:

- The definition in the interim final rule is similar to, or consistent with, standard definitions used in industry and government, including the American Petroleum Institute, the National Petroleum Council, and the Department of Energy's Energy Information Administration.
- We do not segregate reservoirs vertically since the reservoirs are developed from the same platforms and use the same infrastructure. Affected lessees/operators typically make development decisions based on a primary objective(s) knowing that secondary targets exist which they will pursue subsequently.
- Reservoir quality, fluid content, and drive mechanisms are not appropriate determinants for field designations. These factors are reservoir performance/recovery issues. Indeed, such information is rarely available to MMS at the time field determinations are made. We have not considered these factors in our past field designations and their inclusion now would complicate the process significantly and lead to too much subjectivity.
- Elements of the alternative definition, e.g., "a significant interval of nonproductive strata" and "significant lateral separation" would be difficult to define and even more difficult to apply consistently.

We recognize industry's concerns about field designations. This rule establishes, as discussed below, a process whereby lessees may appeal field designations to the Director, MMS.

Other steps include:

- The MMS Field Naming Handbook, which explains our methodology for designating fields, is available on the Internet (www.mms.gov). The Gulf of Mexico Region will entertain suggestions for improvements in the methodology.
- We will elevate the level at which we make field definition decisions in the Gulf of Mexico Region. The Chief, Reserves Section, Office of Resource Evaluation, will make these determinations after a lease has a well into the field qualified as producible.
- As part of the field designation process, affected lessees/operators will have the chance to review and discuss the field designation with Gulf of Mexico Region personnel before MMS makes a final decision.

III. Summary of Modifications to the Interim Final Rule

As discussed below, we have modified the interim final rule to:

- allow for appeals of field designations;
- clarify when the cumulative royalty-suspension volume ends;
- describe how MMS will establish and allocate royalty-suspension volume in fields that have a combination of eligible leases and leases that are granted a royalty-suspension volume under section 302 of the Act; and
- eliminate the reference to a pressure base standard in the provision for the conversion of natural gas to oil equivalency (§260.110(d)(14)). The rule now indicates you must measure that natural gas in accordance with the procedures set forth in 30 CFR 250, Subpart L.

1. We have added a new provision (§260.110(d)(2)) establishing that you or any other affected lessees may appeal to the Director the decision designating your lease as part of a field. The Director's decision is a final agency action subject to judicial review.

2. The preamble to the interim final rule indicated that a royalty-suspension volume would continue until the end of the month in which cumulative production from eligible leases in the field reached the royalty-suspension volume for the field. The interim final rule itself did not include this provision. This final rule now includes a provision (§260.110(d)(10)) that a royalty-suspension volume will continue through the end of the month in which cumulative production from leases in the field entitled to share the royalty-suspension volume reaches that volume. The purpose of this provision is to avoid the complications that would occur for royalty payors if the royalty rate changed in the middle of the month.

3. We have modified §260.110(d)(9) and added a new §260.110(d)(10) to describe how MMS will establish and allocate royalty-suspension volumes in fields having a combination of pre-Act and eligible leases. (Pre-Act leases are defined as OCS leases issued as a result of a sale held before November 28, 1995; in a water depth of at least 200 meters; and in the Gulf of Mexico west of 87 degrees, 30 minutes West longitude. See 30 CFR 203.60 through 203.80). The provisions are necessary to account for and ensure consistency with the deep water royalty relief rules for pre-Act leases (§203.60). We published the interim final rule for pre-Act leases on May 31, 1996 (61 FR 27263), after publication of the interim final rule for new leases in deep water on March 25, 1996.

We have added wording in §260.110(d)(9) for cases where an eligible lease is added to a field that includes pre-Act leases granted a royalty-suspension volume under section 302 of the Act. This rule provides that the addition of the eligible lease will not change the field's established royalty-suspension volume. The added lease(s) may share in the suspension volume even if the volume is more than the eligible lease would qualify for based on its water depth.

The new §260.110(d)(10) describes a case where pre-Act leases in a field that includes eligible leases apply for and receive a royalty-suspension volume larger than the suspension volume established for the field by the eligible leases. This rule provides that the eligible leases may share in the larger suspension volume to the extent of their actual production until cumulative production by all lessees equals the royalty-suspension volume.

4. This final rule states that lessees must measure natural gas in accordance with 30 CFR 250, Subpart L. We have eliminated the specific measurement procedures from the interim final rule because a forthcoming final rule will change those procedures.

IV. Administrative Matters

Executive Order (E.O.) 12866

This rule is a significant rule under E.O. 12866 due to novel policy issues arising out of legal mandates. You may obtain a copy of the determination from MMS. The Office of Management and Budget (OMB) has reviewed this rule.

Regulatory Flexibility Act

The Department of the Interior (DOI) has determined that the primary impact of this rule, i.e., royalty relief to spur deep water oil and gas development, may have a significant effect on small entities although we can't estimate their number at this time. The number of small entities affected will depend on how many of them acquire leases that meet the statutory and regulatory criteria for royalty relief at lease sales between November 28, 1995, and November 28, 2000.

Exploration and development activities in the deep water areas of the Gulf of Mexico have traditionally been conducted by the major oil companies because of the expertise and financial resources required. "Small entities" (classified by the Small Business Administration as oil and gas producers with fewer than 500 employees) are increasingly active on the OCS, including in deep water, and we expect that trend to continue. The only firm to whom we have granted royalty relief so far under section 302 of the Act is a small entity.

In any case, this rule will have positive impacts on OCS oil and gas companies, large or small. Royalty relief in the form of a royalty-suspension volume is automatically established for leases that meet the statutory and regulatory criteria. No applications or special reports are necessary.

The beneficial effect of this relief on companies' financial operations will be substantial. Once we determine that a lease is eligible for a royalty-suspension volume, the value of that relief may range from tens of millions of dollars to over \$100 million. The suspensions will allow companies to recover more of their investment costs before paying

royalties, which may allow greater opportunity for small companies to operate in deep water.

This rule also will have a very positive impact on small entities. Constructing and equipping the platforms and other infrastructure associated with deep water development are huge projects that involve not only large companies but numerous small businesses nationwide as well. Once the platforms are operational, other small businesses will provide supplies and services.

Paperwork Reduction Act

This rule contains no reporting and recordkeeping requirements subject to the Paperwork Reduction Act of 1995.

Takings Implication Assessment

DOI certifies that this rule does not represent a governmental action capable of interference with constitutionally protected property rights. A Takings Implication Assessment prepared pursuant to E.O. 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights, is not required.

Unfunded Mandates Reform Act of 1995

DOI has determined and certifies according to the Unfunded Mandates Reform Act, 2 U.S.C. 1502 et seq., that this final rule will not impose a cost of \$100 million or more in any given year on State, local, and tribal governments, or the private sector.

E.O. 12988

DOI has certified to OMB that this regulation meets the applicable standards provided in section 3(b)(2) of E.O. 12988.

National Environmental Policy Act

We examined this rulemaking and have determined that this rule does not constitute a major Federal action significantly affecting the quality of the human environment pursuant to Section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)).

List of Subjects in 30 CFR Part 260

Continental shelf, Government contracts, Minerals royalties, Oil and gas exploration, Public lands--mineral resources.

Dated.

Assistant Secretary, Land and
Minerals Management.

For the reasons stated in the preamble, the Minerals Management Service (MMS) amends 30 CFR part 260, Subpart B--Bidding Systems, as follows:

PART 260--[Amended]

1. The authority citation for part 260 continues to read as follows:

Authority: 43 U.S.C. 1331 and 1337.

2. In §260.102, the definitions for "Eligible Lease" and "Field" are revised to read as follows:

§260.102 Definitions.

* * * * *

Eligible lease means a lease that results from a sale held after November 28, 1995; is located in the Gulf of Mexico in water depths 200 meters or deeper; lies wholly west of 87 degrees, 30 minutes West longitude; and is offered subject to a royalty-suspension volume authorized by statute.

Field means an area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same general geological structural feature and/or stratigraphic trapping condition. Two or more reservoirs may be in a field, separated vertically by intervening impervious strata, or laterally by local geologic barriers, or by both.

3. In §260.110, paragraph (d) is revised to read as follows:

§260.110 Bidding systems.

* * * * *

(d) This paragraph explains how the royalty-suspension volumes in section 304 of the Outer Continental Shelf Deep Water Royalty Relief Act, Pub. L. 104-58, apply to eligible

leases. For purposes of this paragraph, any volumes of production that are not royalty bearing under the lease or the regulations in this chapter do not count against royalty-suspension volumes. Also, for the purposes of this paragraph, production includes volumes allocated to a lease under an approved unit agreement.

(1) Your eligible lease may receive a royalty-suspension volume only if your lease is in a field where no current lease produced oil or gas (other than test production) before November 28, 1995. Paragraph (d) of this section applies only to eligible leases in fields that meet this condition.

(2) We will assign your lease to an existing field or designate a new field and will notify you and other affected lessees of that assignment. Within 15 days of that notification, you or any of the other affected lessees may file a written request with the Director, MMS, for reconsideration accompanied by a statement of reasons. The Director will respond in writing either affirming or reversing the assignment decision. The Director's decision is final for the Department and is not subject to appeal to the Interior Board of Land Appeals under 30 CFR part 290 and 43 CFR part 4.

(3) The Final Notice of Sale will specify the water depth for each eligible lease. Our determination of water depth for each lease is final once we issue the lease. The Notice also will specify the royalty-suspension volume applicable to each water depth. The minimum royalty-suspension volumes for fields are:

- (i) 17.5 million barrels of oil equivalent (MMBOE) in 200 to 400 meters of water;
- (ii) 52.5 MMBOE in 400 to 800 meters of water; and
- (iii) 87.5 MMBOE in more than 800 meters of water.

(4) When production (other than test production) first occurs from any of the eligible leases in a field, we will determine what royalty-suspension volume applies to the eligible lease(s) in that field. The determination is based on the royalty-suspension volumes specified in paragraph (d)(3) of this section.

(5) If a new field consists of eligible leases in different water depth categories, the royalty-suspension volume associated with the deepest eligible lease applies.

(6) If your eligible lease is the only eligible lease in a field, you do not owe royalty on the production from your lease up to the applicable royalty-suspension volume.

(7) If a field consists of more than one eligible lease, payment of royalties on the eligible leases' initial production is suspended until their cumulative production equals the field's established royalty-suspension volume. The royalty-suspension volume for each eligible lease is equal to each lease's actual production (or production allocated under an approved unit agreement) until the field's established royalty-suspension volume is reached.

(8) If an eligible lease is added to a field that has an established royalty-suspension volume as the result of an approved application for royalty relief submitted under 30 CFR 203 or as the result of one or more eligible leases having been assigned previously to the field, the field's royalty-suspension volume will not change even if the added lease is in deeper water. If a royalty-suspension volume has been granted under 30 CFR 203 that is larger than the minimum specified for that water depth, the added eligible lease may share in the larger suspension volume. The lease may receive a royalty-suspension volume only to the extent of its production before the cumulative production from all leases in the field

entitled to share in the suspension volume equals the field's previously established royalty-suspension volume.

(9) If a pre-Act lease(s) receives a royalty-suspension volume under 30 CFR 203 for a field that already has a royalty-suspension volume due to eligible leases, then the eligible and pre-Act leases will share a single royalty-suspension volume. (Pre-Act leases are OCS leases issued as a result of a sale held before November 28, 1995; in a water depth of at least 200 meters; and in the Gulf of Mexico west of 87 degrees, 30 minutes West longitude. See 30 CFR 203). The field's royalty-suspension volume will be the larger of the volume for the eligible leases or the volume MMS grants in response to the pre-Act leases' application. The suspension volume for each lease will be its actual production from the field until cumulative production from all leases in the field equals the suspension volume.

(10) A royalty-suspension volume will continue through the end of the month in which cumulative production from leases in a field entitled to share the royalty-suspension volume reaches that volume.

(11) If we reassign a well on an eligible lease to another field, the past production from that well will count toward the royalty-suspension volume, if any, specified for the field to which it is reassigned. The past production will not count toward the royalty suspension volume, if any, for the field from which it was reassigned.

(12) You may receive a royalty-suspension volume only if your entire lease is west of 87 degrees, 30 minutes West longitude. A field that lies on both sides of this meridian will

receive a royalty-suspension volume only for those eligible leases lying entirely west of the meridian.

(13) Your lease may obtain more than one royalty-suspension volume. If a new field is discovered on your eligible lease that already benefits from the royalty-suspension volume for another field, production from that new field receives a separate royalty suspension.

(14) You must measure natural gas production subject to the royalty-suspension volume as follows: 5.62 thousand cubic feet of natural gas, measured in accordance with 30 CFR 250, Subpart L, equals one barrel of oil equivalent.